



Comptroller of the Currency
Administrator of National Banks

Limited Purpose

Public Disclosure

October 9, 2001

Community Reinvestment Act Performance Evaluation

**Dillard National Bank
Charter Number: 18777**

**396 North William Dillard Drive
Gilbert, Arizona 85233**

**Office of the Comptroller of the Currency
Western District Office
50 Fremont Street, Suite 3900
San Francisco, CA 94105**

NOTE: This document is an evaluation of this institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion, or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

Institution's CRA rating:

This institution is rated Satisfactory.

The conclusions for the three rating criteria are:

- The bank demonstrates an adequate level of community development (CD) services and qualified investment activity.
- The bank demonstrates occasional use of innovative qualified investments and community development services.
- The bank demonstrates adequate responsiveness to credit and community development needs in its assessment area.
- The bank's violations of the Equal Credit Opportunity Act (Regulation B) had some impact on the bank's CRA rating, but did not result in a less than satisfactory rating.

Scope of the Examination

In evaluating the bank's performance under the CRA, we reviewed community development activities from **August 1, 1997** through **October 9, 2001**. We reviewed the level and nature of qualified investments, and community development services. At the bank's request, we also considered qualified investments provided by its affiliates. At the prior examination dated **July 31, 1997**, we rated the bank Satisfactory.

If a bank has adequately addressed its assessment area needs, the OCC considers CD activities the bank submits that benefit areas outside of its assessment area in the evaluation of its performance. The bank has adequately addressed the needs of its assessment area, and therefore, qualified investments outside the bank's assessment area were considered in evaluating its performance.

Description of Institution

Dillard National Bank, Arizona (DNB-AZ) is headquartered in Gilbert, Arizona. The bank has no branches. DNB-AZ is a credit card bank under the Competitive Equality Banking Act (CEBA) of 1987. The bank was chartered June 18, 1991, and received its designation as a limited purpose bank for purposes of the Community Reinvestment Act (CRA) effective May 1, 1996. CEBA credit card banks are subject to significant activity restrictions. These banks must:

- Engage only in credit card operations;

- Not accept demand deposits or other deposits able to be withdrawn for payment to third parties;
- Not accept any savings or time deposits less than \$100 thousand (except for collateral purposes);
- Maintain only one office that accepts deposits; and
- Not engage in the business of making commercial loans.

DNB-AZ issues a private label credit card for customers who shop at the 342 affiliated Dillard retail stores located in 29 southeastern, mid-western, and western states. As of June 30, 2001, the bank reported total assets of \$27.9 million and year-to-date (YTD) net income of \$205 thousand. DNB-AZ is a wholly owned subsidiary of Dillard Investment Co., Inc. (DIC). DIC is the wholly-owned finance subsidiary of Dillard's, Inc. (DDS on the New York Stock Exchange.) DDS is headquartered in Little Rock, Arkansas. As of August 4, 2001, the end of the Company's second quarter, DDS reported total assets of \$7.1 billion and net income of \$10 million.

DNB-AZ has approximately 470 full- or part-time employees. The bank shares a common management team and Board of Directors with its affiliate, Dillard National Bank, Baton Rouge, Louisiana. The bank and its Louisiana affiliate's operational functions are also consolidated at the Gilbert, Arizona location.

In 1998, the bank began selling all of its receivables, without recourse, on a daily basis to a related entity, Dillard Asset Funding, which transfers the assets to a Master Trust. The bank retains ownership of the accounts and services the receivables. Total receivables attributed to accounts owned by DNB-AZ were approximately \$1 billion as of June 30, 2001.

Table 1: Financial Information (000s)

	Year-end 1997	Year-end 1998	Year-end 1999	Year-end 2000	Most Recent Quarter-end 06/30/2001	Average for Evaluation Period***
Tier 1 Capital	174,515*	19,336*	16,057*	13,575*	12,280*	15,312
Total Income	22,877*	16,456*	10,822*	4,953*	660**	8,223
Net Operating Income	14,483*	10,389*	6,721*	3,068*	410**	5,147
Total Assets	1,277,170*	21,535*	23,213*	23,589*	27,887*	24,056
Pass-Through Receivables	1,258,607*	1,249,933*	1,249,454*	1,187,119*	1,025,705*	1,194,614

Source: Consolidated Report of Condition and Income and bank reported data.

*Actual reported data.

**Annualized data reported.

***Averages for Tier I, Total Income, Net Operating Income, and Total Assets exclude 1997 data. Information from 1997 is not reflective of the bank's operations during the majority of the evaluation period. In 1998, the bank began selling its account receivables on a daily basis, which resulted in an OCC-approved capital reduction.

Description of Assessment Area

DNB-AZ operates in an urban area. The bank has designated Maricopa County as its assessment area, which consists of 466 census tracts in the Phoenix MSA. The assessment area meets the legal requirements of the CRA. The table below shows the demographics of the bank's assessment area.

Table 2: Assessment Area Description

	Number	Low	Moderate	Middle	Upper
Tracts***	466	6%	23%	38%	32%
Families	552,909	19%*	18%*	23%*	40%*
Businesses	108,766	5%**	22%**	37%**	36%**

Source: Demographic Data - 1990 U.S. Census, Dun & Bradstreet Data.

*Represents families by income level.

**Represents businesses by income level of census tract.

***Does not add to 100% as four, or 1%, of the Census Tracts are not income categorized

Maricopa County is one of the largest counties in the country stretching 100 miles in diameter and covering a total of 9,222 square miles. It is the fastest growing county in the nation with an estimated population over 2.9 million as of December 31, 2000. Sixty percent (60%) of the state's population resides in Maricopa County. The county is comprised of the city of Phoenix and several small cities such as Avondale, Buckeye, Chandler, Goodyear, Glendale, Mesa, Scottsdale, Tempe, and Wickenburg. In addition to the urban cities in the county, there is a large unincorporated area and several Indian reservations.

Maricopa County's main economic sectors include services, trade, and manufacturing. The area is in the midst of an economic growth period supported by thriving high tech, tourism, biomedical, and transportation industries. The 2001 HUD updated median family income is \$54,900. As of July 2001, the county's unemployment rate was at 3.5%. The 1990 census data indicates a median housing price of \$87,219. However, various non-profit organizations indicated that since 1990, the average sales price has increased to \$160,000, placing home ownership out of the reach of most LMI families in the area.

There are a number of competing financial institutions in the assessment area. Some of these are significantly larger and have more dedicated resources for community development loans and investments. While other financial institutions are smaller, they also compete for available investments in the assessment area. These include, but are not limited to, Bank One, N.A.; Wells Fargo Bank, N.A.; First American National Bank; Johnson Bank Arizona, N.A.; Union Bank of Arizona, N.A.; Zions National Bank; Sears National Bank; Direct Merchants Credit Card Bank, N.A.; NextBank, N.A.; and Northern Trust Bank of Arizona, N.A.

In conjunction with this examination, we interviewed one representative from a community organization that provides affordable childcare for LMI families. We also reviewed 22 contacts performed by the OCC and various other banking regulatory agencies. In summary, twelve of the contacts were affordable housing providers, four were small business providers, four focused on economic development, and two provided services for LMI. The contacts indicated that

community development needs in Maricopa County are similar to those throughout the country. These revolve around affordable housing and small businesses. In addition, there is a significant need for providing community development services for LMI.

Affordable housing needs run the gamut from affordable rental properties to affordable properties available for purchase by LMI families. Community development needs include affordable home purchase loans for LMI individuals, subsidies for down payment assistance and closing costs, and innovative and flexible construction and renovation loans for affordable single and multi-family housing. In some parts of the city of Phoenix, FHA loans are not available. Sovereignty issues have limited lending on the local Indian reservations. Affordable housing developers have problems meeting the market driven terms offered by some of the banks and local intermediaries. And, land acquisition is growing increasingly difficult with the growth of retirement and other planned communities.

Small business needs are the same as in other parts of the state and country. There is a need for micro loans for very small businesses and start-up small business loans. Currently, there is only one SBA micro-lender operating in the area. Start-up loans are only available through the SBA, and require a substantial equity injection. Technical assistance remains an ongoing need for small business owners. Some intervention has been provided by the local Service Core of Retired Executives (SCORE) chapters, and by the local Small Business Development Corporations (SBDCs). However, many small business owners still need education and counseling regarding business management, management of credit card debt, and preparing business plans.

There is also a need to provide funding which will in turn provide affordable housing and other types of consumer loans for LMI individuals and families. And, there is a need to provide funding to agencies that provide assistance to LMI families that are attempting to achieve economic self-sufficiency.

There is a major barrier to the CEBA banks directly meeting the most urgent community development needs in the area of lending. Since CEBA banks are prohibited from lending, except for the issuance of credit cards, they are unable to meet most of the affordable housing and small business loan needs. However, there are a few investment opportunities. There are also opportunities for community development (CD) grants. Although several groups indicated that they had received operating or project-related grants from some of the credit card banks, they indicated the grants were small, most were less than \$10,000. And, there are still opportunities for CEBA banks to provide a service in the area of consumer and small business education. There are also opportunities for the CEBA banks to make below market rate deposits at community based credit unions and community development financial institutions (CDFIs).

Conclusions About Performance

Summary

The overall level of qualified community development investments and services is adequate, particularly considering the opportunities available for CEBA banks in this assessment area. We based our conclusions primarily on the bank's good efforts to help meet a variety of credit needs in the assessment area. DNB-AZ provided funding which in turn helped provide affordable housing loans for LMI, daycare for low-income families, and personal and mortgage loans to meet the needs of LMI families. Bank management also provided financial education for small business owners and LMI individuals, and financial expertise to community development organizations.

DNB-AZ demonstrated creativity and initiative to help meet the varied needs of its assessment area. The bank demonstrated originality when it played a leadership role in developing a small business roundtable discussion. This technical workshop was successful in helping small business owners learn how to improve their financial position through merchandising, promotions, and marketing. Bank management used considerable effort to develop, plan, and coordinate the roundtable, which was one of the first of its kind in Maricopa County.

The bank's responsiveness to community development needs in the assessment area is adequate. A majority of the bank's qualified investments and services assisted with meeting identified credit needs, including small business education and assisting with housing needs and other community services for LMI. Community groups indicate there is a significant need for financing to help provide affordable housing for LMI. There is also a need for training and education for small business owners and LMI individuals. And, there is a critical need to help LMI individuals/families achieve economic self-sufficiency.

Qualified Investments

During the review period, DNB-AZ provided almost \$5 million in investments and grants to community development organizations. About \$1.3 million benefited the assessment area and \$3.7 million benefited areas outside the bank's assessment area. In addition, the bank provided another \$85 thousand investment in the assessment area during the review period, which matured in January 2001. It is not reflected in the tables below, since it was no longer outstanding at the time of this examination.

Table 3a: Qualified Investment Activity (000s)

	Benefits AA	Outside AA	Totals
Originated Investments	\$ 410	\$ 0	\$ 410
Originated Grants	\$ 923	\$3,664	\$4,587
Prior-Period Investments that Remain Outstanding	\$ 0	\$ 0	\$ 0
Total Qualified Investments	\$1,333	\$3,664	\$4,997

Table 4a: Qualified Investment Percentages

	Benefits AA (%)	Outside AA (%)	Total (%)
Total Investments/Average Tier 1 Capital	9%	24%	33%
Total Investments/Average Total Income	16%	45%	61%
Total Investments/Average Pass-Through Receivables	0.1%	0.3%	0.4%

DNB-AZ's most notable qualified investments/grants in the assessment area consist of the following:

- \$552 thousand in grants to community development organizations. These organizations focus on providing housing, including temporary housing, or provide services that assist low-income families to achieve economic self-sufficiency.
- \$125 thousand represents an industrial revenue bond, which helps provide housing for LMI individuals. During the review period, the bank also had an \$85 thousand affordable housing industrial revenue bond of the same type, which matured in January 2001.
- \$100 thousand certificate of deposit in a community development financial institution (CDFI), which was chartered to meet the unique credit needs of Native Americans in the assessment area. The bank has renewed the certificate of deposit annually for the past five years, and thus provided a continuous source of funds for loans to LMI individuals.
- \$100 thousand certificate of deposit in a CDFI which was chartered to aid in the advancement of education, health, economic development, employment, and housing status of the Hispanic community. The CDFI provides small loans of all types to LMI persons in the assessment area. The bank has renewed the certificate of deposit annually for the past five years, and thus provided a continuous source of funds for loans to LMI individuals.
- \$85 thousand in mortgage backed securities; the majority consists of mortgage loans to LMI individuals.
- \$4 thousand grant, which provided the equipment and supplies necessary for a daycare center to acquire certification and open for business. The center will provide daycare for as many as 140 children in a low-income neighborhood where the average household income for a family of three is estimated at \$12,600 annually (less than the poverty level). The program is intended to help low-income families achieve economic self-sufficiency.

The remaining grants consist of \$367 thousand to such organizations as Consumer Credit Counseling Services (CCCS). Data indicates that a significant majority of individuals who seek credit counseling are LMI.

Since the bank's investments in its assessment area are adequate, we also considered the bank's investments/contributions outside its assessment area. These investments consisted of \$2.2 million in grants to community development organizations which provide services for LMI individuals and \$1.5 million in CCCS contributions.

Community Development Services

During the review period, DNB-AZ provided community development services to the following three community development organizations in its assessment area:

- Through discussions with the Arizona Multi-Bank Community Development Corporation, bank management determined there was a need for specialized technical training for small business owners. DNB-AZ played a leadership role in developing an innovative pilot program that provided roundtable discussion training to small business owners. It is one of the first programs of its kind in Maricopa County. Representatives from Dillard's, Inc. provided the training. The training explored ways to assist small business owners in maximizing earnings. It provided education in the areas of merchandising, promotions, and marketing. During the roundtable discussion, a local small business successfully marketed its product to the buyers of Dillard's southwest division for sale at Dillard's stores.
- Nine of DNB-AZ's employees became certified volunteer educators for CCCS Southwest. The employees assist CCCS in providing credit education, primarily for LMI individuals in the assessment area.
- The bank president provides financial expertise by serving on the board of CCCS and on the board of an organization which provides affordable housing for LMI individuals.

Fair Lending Review

We assessed the bank's compliance with fair lending laws and regulations during our August 1999 examination. During this examination, we reviewed the bank's policies, procedures, training, application forms, credit solicitations, and actual practices. We found substantive violations of the Equal Credit Opportunity Act (Regulation B) which involved differential treatment of cardholders, applicants and prospective applicants based on marital status. The problems discovered involved a number of bank policies and were systemic in nature. However, we do not have any evidence that these practices specifically harmed LMI individuals. Management and the Board have addressed the violations. Therefore, the CRA rating was not adjusted downward.

Definitions and Common Abbreviations

The following terms and abbreviations are used throughout this performance evaluation. The definitions are intended to provide the reader with a general understanding of the terms, not a strict legal definition.

Affiliate – Any company that controls, is controlled by, or is under common control with another company. A company is under common control with another company if both companies are directly or indirectly controlled by the same company. A bank subsidiary is controlled by the bank and is, therefore, an affiliate.

Assessment Area (AA) – A geographic area that consists generally of one or more MSAs (using the MSA boundaries that were in effect as of January 1 of the calendar year in which the delineation is made) or one or more contiguous political subdivisions, such as counties, cities, or towns, in which the bank has its main office, branches, and deposit-taking ATMs.

Benefit to Assessment Area – A qualified Community Development activity benefits the assessment area if (i) the activity benefits areas within the assessment area, or (ii) the activity benefits a broader statewide or regional area that includes the bank’s assessment area. If a bank has adequately addressed the needs of its assessment area, then the OCC also considers activities submitted by the bank that benefit areas outside of its assessment area.

Block Numbering Area (BNA) – Statistical subdivisions of counties in which census tracts have not been established. The United States Census Bureau has established BNAs in conjunction with state agencies.

CEBA – Competitive Equality Banking Act of 1987, which permitted corporations to form limited-purpose credit card banks, whose operations are restricted to credit card activities, without the corporation becoming subject to the limitations of a “bank holding company” under the Bank Holding Company Act. A CEBA credit card bank engages only in credit card operations, does not accept demand deposits or savings or time deposits of less than \$100,000 (other than to secure extensions of credit), maintains only one office and does not engage in the business of making commercial loans

Census Tract (CT) – Small, locally defined statistical areas within metropolitan statistical areas. These areas are determined by the United States Census Bureau in an attempt to group homogenous populations. A CT has defined boundaries per 10-year census and an average population of 4,000.

Community Development (CD) – Affordable housing for low- or moderate-income individuals; community services targeted to low- or moderate-income individuals; activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration’s Development Company or Small Business Investment Company programs (13 CFR 121.301) or have gross annual revenues of \$1 million or less; or activities that revitalize or stabilize low- or moderate-income geographies.

Community Reinvestment Act (CRA) – The statute that requires the OCC to evaluate a bank’s record of meeting the credit needs of its local community, consistent with the safe and sound operation of the bank, and to take this record into account when evaluating certain corporate applications filed by the bank.

Geography – A census tract or a block numbering area delineated by the United States Bureau of the Census in the most recent decennial census.

Limited Purpose Institution – An institution that offers only a narrow product line (such as credit cards or automobile loans) to a regional or broader market and for which a designation as limited purpose bank is in effect.

Median Family Income (MFI) – The median income determined by the United States Census Bureau every 10 years and used to determine the income level category of geographies. Also, it is the median income determined by the Department of Housing and Urban Development annually that is used to determine the income level category of families. For any given geography, the median is the point at which half of the families have income above it and half below it. (See the four categories of median income below.)

- **Low-Income** – An income level that is less than 50% of the MFI.
- **Moderate-Income** – An income level that is at least 50% and less than 80% of the MFI.
- **Middle-Income** – An income level that is at least 80% and less than 120% of the MFI.
- **Upper-Income** – An income level that is 120% or more of the MFI.

Metropolitan Statistical Area (MSA) – Area defined by the director of the United States Office of Management and Budget. MSAs consist of one or more counties, including large population centers and nearby communities that have a high degree of interaction.

Net Operating Income – As listed in the Consolidated Report of Condition and Income: Income before income taxes and extraordinary items and other adjustments.

Pass-Through Receivables – Outstanding receivables tied to all accounts issued or owned by the bank. Pass-through receivables include receivables attributable and receivables retained on balance sheet as those terms are used in 12 CFR 8.

Tier 1 Capital – The total of common shareholders’ equity, perpetual preferred shareholders’ equity with noncumulative dividends, retained earnings and minority interests in the equity accounts of consolidated subsidiaries.

Total Assets – Total bank assets as listed in the Consolidated Report of Condition and Income.

Total Income – From the Consolidated Report of Condition and Income – Total Interest income plus Total Non-interest income.